

**ILLINOIS-AMERICAN WATER COMPANY**  
**DOCKET 10-0366**  
**Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

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**INTRODUCTION**

Pursuant to the June 2, 2010 Order Initiating Management Audit (“Initiating Order”) in Docket 10-0366, Illinois-American Water Company (“IAWC” or the “Company”) hereby respectfully submits its response to the Confidential Final Report, Management Audit of the Fees Assessed to Illinois American Water Company (IAWC) by Its Affiliated Service Company, IAWC Management Audit ICC11W0001 (the “Audit Report”), as prepared and provided by NorthStar Consulting Group (“NorthStar”) on or about January 11, 2012 and as filed with the Illinois Commerce Commission (the “Commission”) by IAWC on or about that date.

The Initiating Order requires IAWC to file a response to the Audit Report. In responding to the Audit Report, IAWC is addressing only “results” set forth in the Audit Report related to the four areas in which the Audit Report states “attention . . . should be focused.”<sup>1</sup> IAWC’s responses are directed to certain findings identified in the Executive Summary of the Audit Report with which IAWC disagrees. However, IAWC’s decision not to specifically address in the instant response a result, conclusion, finding or statement in the Audit Report does not mean that IAWC either agrees or disagrees, in whole or in part, with such result, conclusion, finding or statement. Moreover, IAWC’s instant response should not be understood to imply IAWC either agrees or disagrees with the methodology, or any part thereof, utilized by NorthStar in

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<sup>1</sup> January 11, 2012 *Confidential Final Report, Management Audit of the Fees Assessed to Illinois American Water*

researching and preparing the Audit Report, and IAWC expressly makes no concessions or implications in this regard.

IAWC's response is necessarily limited by the circumstances known to it at the time of this response. In addition, although IAWC has requested certain documentation supporting the Final Audit Report via data requests submitted to NorthStar on or about January 13, 2012, NorthStar has not responded to those data requests. As such, IAWC's instant response is necessarily limited by the lack of information regarding the bases for the results, conclusions, statements and/or findings contained in the Audit Report. IAWC's response may also be limited by: (1) missing, incomplete and/or inaccurate references and/or citations contained in the Audit Report; (2) information unknown to IAWC at the time of the instant response which subsequently becomes known to IAWC during the course of discovery and/or the evidentiary hearing in this proceeding or otherwise; (3) documents, information and/or materials on which the Audit Report, or any portion thereof, is based which are outside the possession, custody and/or control of IAWC or its affiliates; (4) proposed corrections, modifications and/or additions to the Audit Report which are made subsequent to the filing of the instant response by NorthStar, the Commission's Staff, the AG and/or any other party subsequently intervening in this docket; (5) disagreements regarding the meaning of any terms, explanations, descriptions, results, conclusions, analyses, findings and/or any other statements contained in the Audit Report; (6) omissions from or errors within the Audit Report not evident on the face of the Audit Report; and (7) any other circumstance arising and/or being made known to IAWC after the filing of the instant response. Accordingly, IAWC reserves the right to modify, supplement, add to and/or otherwise amend the instant response as circumstances require, and IAWC's response should not be construed to be, and does not constitute, a waiver of IAWC's right to do so.

## **PROCEDURAL BACKGROUND**

On May 5, 2010, the Commission entered an Amendatory Order in IAWC's last rate case, Docket 09-0319, in which it ordered that a management audit of IAWC's Service Company fees be performed pursuant to the Commission's authority under 220 ILCS 5/8-102. On June 2, 2010, the Commission issued an Order initiating that audit, directing it to be performed by Staff or by a firm independent of IAWC, its affiliates, Staff or other parties to Docket 09-0319. (Docket 10-0366 Initiating Order.) The Commission further directed that the purpose of the audit was to compare the costs of each service obtained by IAWC from its affiliate American Water Works Service Company, Inc. ("AWWSC" or the "Service Company") to the costs of such services had the services been obtained through competitive bidding on the open market. In a subsequent Staff Report to the Commission, Staff determined that it was necessary to engage an independent firm to conduct the audit in order to meet the six-month timeframe imposed by the Amendatory Order. Thereafter, Staff initiated an RFP process to engage an independent firm and, as a result of that process, on July 11, 2011, a contract was signed with NorthStar.

The Initiating Order sets forth certain tasks IAWC was required to undertake related to the management audit, including, but not limited to: (1) during the RFP process, compile and have ready for the independent auditor certain specified information on the Service Company, its services and their costs; (2) provide office space for the independent auditor; (3) be available to explain IAWC record-keeping processes, contracting processes and internal controls as determined necessary by the independent auditor; and (4) participate in scheduled meetings with the independent auditor and Staff to discuss audit-related issues, review audit progress, and ensure adequacy of responses to the independent auditor's requests. IAWC complied with those requirements. Specifically, during the RFP process referenced above, IAWC compiled and made

ready information regarding the Service Company as specified by the Initiating Order. IAWC also provided office space for use by NorthStar personnel when on IAWC grounds. Space was also made available at the Service Company's headquarters in New Jersey. In addition, IAWC worked diligently to timely make available Company personnel in response to requests for interviews from NorthStar and to timely provide complete responses to NorthStar's data requests during the course of the audit. In total, NorthStar conducted 68 interviews of IAWC and Service Company employees in Belleville, Illinois, Alton, Illinois and Woodcrest, New Jersey. NorthStar also issued 412 data requests. IAWC responded to those data requests, providing over 11,000 pages of information and documents to NorthStar. IAWC dealt fairly and openly with NorthStar at all times during the audit process to ensure a complete and effective management audit.

On or about November 26, 2011, NorthStar submitted to Staff a draft of the Audit Report. Staff provided the draft to IAWC on or about December 2, 2011. IAWC reviewed the draft Audit Report and, on or about December 12, 2011, IAWC provided Staff and NorthStar with technical corrections to the draft Audit Report IAWC deemed necessary. Thereafter, on or about January 11, 2012, NorthStar provided Staff and IAWC with the final Audit Report, which IAWC filed with the Commission on or about the same date. The Audit Report indicates approximately 85-90% of the charges for the services which IAWC obtained from the Service Company in 2010 are at or below market cost ranges. The Audit Report also found many cases where the Service Company's consolidated services and economies of scale provide substantial benefits to IAWC and/or where it would not be appropriate or beneficial for IAWC to outsource the services it receives from the Service Company. As discussed herein, IAWC disagrees with certain of the Audit Report's conclusions regarding the potential economic benefits of outsourcing.

## **GENERAL COMMENTS ON AUDIT REPORT'S OUTSOURCING RECOMMENDATIONS**

The Audit Report makes certain statements regarding the potential financial benefits of outsourcing certain services. These statements are individually addressed below. However, IAWC has certain general comments with the Audit Report's methodology for determining outsourcing benefits and the suitability of related data. These general comments are summarized as follows.

### **1. Vendor Pricing Data**

Certain of the outsourcing conclusions in the Audit Report are based on market analyses, including information obtained by contacting vendors to obtain pricing information. IAWC has received workpapers from the auditor regarding these analyses. However, the workpapers do not contain detailed information regarding the type of information sought from the vendors. Hence, IAWC cannot ascertain whether service level requirements were accurately specified to vendors to obtain vendor price estimates that reflect the same scope of services as the Service Company provides to IAWC.

Within the Audit Report, some of the key outsourcing conclusions were based on a very limited set of vendor pricing data. For instance, in estimating cost savings for accounting services, only two vendor quotes were obtained, and the one finally selected was used because it was the cheapest cost provider. IAWC believes using such a limited market pricing data set does not represent an open market "competitive bidding." Selecting a vendor quote purely on lowest cost basis, even assuming that the proper scope of work was provided to the vendor before the price quote was given, ignores quality of service levels that are critical to meet IAWC's customers' expectations.

Furthermore, in the quotes the Audit Report obtained, there was a wide range in vendor pricing estimates, raising additional concerns on the Audit Report's market data collection process. IAWC postulates two potential issues that may have driven this wide range:

- a) Lack of clarity in the specific scoping of work and nature of work activities outlined in the Audit Report's RFIs, resulting in uncertainty for vendors regarding the exact level of services they were to provide.
- b) The scope and cost of services were variable, driven by varying levels of engagement necessary to provide the services outlined.

Given the limited number of pricing estimates and the selection of vendors purely on lowest cost basis, IAWC has concerns that the vendor data used in the Audit Report study may not be suitable to draw these conclusions.

## **2. Economic Value of Outsourcing Is Overstated**

In addition to the above concerns on vendor data, the Audit Report's usage of the vendor data is skewed to overstate the potential savings from outsourcing. The Audit Report claims the economic potential for competitively outsourced services to be \$3.3 - \$3.5 million.<sup>2</sup> However, the Audit Report used only the lowest cost estimate from the pricing range that responding vendors provided for each function, and in doing so, ignored the variability among vendor service offerings. For example, some vendor pricing ranges (e.g., accounting) had upper bound price estimates higher than the cost of services from the Service Company for a particular function, yet the Audit Report discarded those higher estimates and assumed, without explanation, that the lower bound estimates below Service Company costs should be used. If alleged potential savings are calculated using the higher end estimates of the pricing data

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<sup>2</sup> Audit Report, p. II-2.

gathered (see Table 1 below), potential savings from outsourcing is reduced to \$1.5 million, a difference of 59% from the Audit Report's calculation.

Furthermore, the Audit Report's calculations do not include one-time costs of outsourcing (e.g., contract negotiation, severance for current employees, data transfer costs) or new on-going costs arising from outsourcing (e.g., costs of vendor management and oversight positions). Including these costs would further reduce the potential benefits of outsourcing.

**Table 1: Range of Estimates for Benefits of Outsourcing**

Potential Outsourcing Opportunity	Lower Bound	Upper Bound	Notes / Reference
<b>TOTAL</b>	<b>\$1,465,266</b>	<b>\$3,575,266</b>	
V1-2: Accounting Functions	(\$387,694)	\$1,052,306	<ul style="list-style-type: none"> <li>Does not consider one-time set-up costs</li> <li>Exhibit VI-6, pg. V1-7</li> </ul>
IX-2: Contact Center Services	\$428,831	\$428,831	<ul style="list-style-type: none"> <li>Does not consider \$200,000 in start-up costs</li> <li>Exhibit IX-3, pg. IX-9</li> </ul>
X-4: Professional Employer Organization	\$17,272	\$467,272	<ul style="list-style-type: none"> <li>Does not consider one-time start-up costs</li> <li>Exhibit X-6, pg. X-9</li> </ul>
X-9: HR Administrative Services	\$245,589	\$275,589	<ul style="list-style-type: none"> <li>Does not include \$17,000 set-up cost</li> <li>Exhibit X-7, pg. X-12</li> </ul>
XIII-1: Executive Assistant Support	\$401,756	\$401,756	<ul style="list-style-type: none"> <li>Potential mis-charge</li> <li>Exhibit XIII-3, pg. XIII-6</li> </ul>
XIII-3: Network Services Support	\$101,204	\$101,204	<ul style="list-style-type: none"> <li>Potential mis-charge</li> <li>Exhibit XIII-5, pg. XIII-7</li> </ul>
XIII-4: Executive Management Services	\$338,771	\$338,771	<ul style="list-style-type: none"> <li>Potential mis-charge, unrelated to outsourcing potential</li> <li>Pg. XIII-9</li> </ul>
XVII-3: Central Lab	\$15,672	\$15,672	<ul style="list-style-type: none"> <li>Charge allocation rate issue</li> <li>Exhibit XVII-2, pg. XVII-5</li> </ul>
XVII-4: Central Lab	\$193,455	\$193,455	<ul style="list-style-type: none"> <li>Potential mis-charge</li> <li>Pg. XVII-5</li> </ul>
XXII-4: Business Development	\$81,410	\$271,410	<ul style="list-style-type: none"> <li>Upper bound does not include full range of BD services</li> <li>Exhibit XXII-3, Pg. XXII-6</li> </ul>
XXIII-1: Government Affairs	\$29,000	\$29,000	<ul style="list-style-type: none"> <li>Does not include one-time set-up costs or offsetting costs</li> <li>Pg. XXIII-4</li> </ul>



### **3. The Audit Report Selectively Groups AWWSC Functions without Accounting for Impacts to AWWSC Efficiency of Operations**

The Audit Report recommends that IAWC outsource a subset of the total portfolio of services currently provided by the Service Company. For instance, the Audit Report has selected certain individual functions from the Service Company's Finance unit and Shared Services unit relating to revenue processing, expense transactions, and internal reporting, and grouped these functions as 'Accounting Services' as a potential candidate for outsourcing. There are at least two major problems with such a selection process: a) certain functions cannot be provided by non-AWK affiliates due to concerns stemming from data sensitivity, regulatory requirements, and response to emergency events (e.g., Benefit Service Center, Customer Contact)<sup>3</sup>; and b) because of IAWC's small size and low volumes<sup>4</sup>, there are few interested vendors for certain functions in the marketplace. Selectively identifying individual functions for outsourcing will erode the benefits from economies of scale the Service Company is able to achieve by aggregating demand across multiple subsidiaries as reflected in its current cost structure. The Service Company's expertise in the water utility industry and detailed knowledge of IAWC's operations and facilities also provides scale benefits in the form of employee training and specialized services to IAWC. Outsourcing only selected functions may reduce the economies of scale that AWWSC is able to provide IAWC. Further, selective outsourcing is likely to be disruptive for IAWC, as certain sub-functions are outsourced and others are not, thus requiring an increased level of coordination by the utility to manage the services.

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<sup>3</sup> Audit Report, p. I-4.

<sup>4</sup> Audit Report, p. IX-8.

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**EXECUTIVE SUMMARY STATEMENT: III-1. AWWSC does not consistently adhere to its second cost assignment principle – direct charging – whenever possible.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

Under the approved Service Company Agreement, Service Company charges that can be identified and related directly to IAWC should be direct charged to IAWC. Charges for services rendered to American Water operating companies in common, however, are allocated. The Audit Report asserts the Service Company does not consistently adhere to its second cost assignment principle, namely direct charging hours whenever possible. The basis for this assertion is an analysis of Service Company hours charged to IAWC in 2010. That analysis concluded that only 17% of hours charged by Service Company personnel were charged directly. There are no comparative statistics for direct charging offered by the Audit Report which support that conclusion. Given that much of the work performed by Service Company personnel is “common” to more than a single company, and is likely to be “common” to most or all of the companies for which services are performed, it is unlikely that Service Company can meaningfully increase the percentage of time charged directly to close to 100%. Moreover, this conclusion ignores the fact that the Service Company consistently seeks to implement measures to increase direct charges to the extent it is feasible to do so. The Service Company will

continue to move toward more direct charging as technology and work processes enable it to do so.

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**EXECUTIVE SUMMARY STATEMENT: III-2. AWWSC does not consistently adhere to its fourth cost assignment principle – accurate billing.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

IAWC's position is that it has substantial procedures in place for reviewing Service Company bills, as set forth in IAWC's testimony in Docket 09-0319<sup>5</sup>. The Audit Report alleges certain 2010 Service Company overcharges and billing inaccuracies. However, IAWC points out, of the \$25,915,258 in 2010 Service Company charges noted by the Audit Report, it alleges only \$228,416 in alleged billing errors<sup>6</sup> (IAWC disagrees with the Audit Report regarding a number of those alleged overcharges and errors, as discussed hereinafter.) Accordingly, of the approximately \$26 million in Service Company charges billed to IAWC in 2010, less than 1% were allegedly billed in error. Thus, although the Audit Report criticizes the Service Company's timekeeping systems and processes<sup>7</sup>, the fact that it identifies less than 1% of errors in billing shows that the Service Company is, in fact, adhering to its policy of accurate billing.

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<sup>5</sup> Docket 09-0319, IAWC Ex. 1.00 (Teasley Dir.).

<sup>6</sup> Audit Report, pp. II-3 - II-4.

<sup>7</sup> Audit Report, p. III-10.

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**EXECUTIVE SUMMARY STATEMENT: III-3. IAWC does not adequately review monthly charges from AWWSC and has no information to determine if AWWSC's bills are accurate.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

IAWC has significant and thorough review processes in place to monitor and control Service Company charges on an ongoing basis. In addition to having extensive processes in place to prepare, approve and review annual budgets to ensure that Service Company costs charged to IAWC are necessary and controlled, several layers of oversight also ensure that Service Company costs are reasonable and accurate. Notably, divisional American Water executives and directors oversee IAWC's finances and spending as well as the Service Company's activities. Financial analysts on that Central Division Finance team monitor Service Company performance and reporting and, jointly with IAWC's President, contest bills whenever they believe Service Company quality and/or service are not appropriate. In addition, IAWC's Senior Finance Manager and its President review Service Company billings on a monthly basis for a final "on the ground" review of the charges included in the billings.

As discussed in IAWC's response to III-2 above, less than 1% of the total Service Company charges to IAWC in 2010 were allegedly billed in error. This alone indicates IAWC's review processes are not only adequate, but also serving IAWC well. Moreover, although the

Audit Report criticizes the extent of detail in Service Company billing, it does not acknowledge that substantial levels of detail are in fact available to the utility, or, as discussed below, the utility's extensive review process regarding that information.

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**EXECUTIVE SUMMARY STATEMENT: XVIII-2. Non-regulated AWK entities (IAWC affiliates) are subsidized by the regulated utilities when they utilize AWWSC national contract agreements and pricing but are not charged for supply chain services.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

The Audit Report does not properly characterize the relationship between the Service Company's Supply Chain function and the non-regulated companies. The statement that non-regulated companies are not charged for Supply Chain's services is not correct. Rather, if a specific sourcing event is conducted for a non-regulated entity, they are direct charged for that specific event. Further, inclusion of non-regulated affiliates in Supply Chain agreements benefits all entities participating in the contract. Supply Chain strategically sources categories based on the direction, requirements and decisions of the regulated American Water entities. Supply Chain national agreements are drafted to be inclusive of "American Water and its Affiliates." This is done for the practical purpose of not having to alter a number of agreements in the event of organizational changes. Further, participation of non-regulated utilities increases the amount of spend under the agreements. Allowing for additional spend with suppliers (based on the ability of non-regulated affiliates to add to the total spend) increases the Service Company's leverage during any price negotiations, which benefits the regulated entities. Finally, a little over 2% (\$12.6M) of total spend with Supply Chain contracted suppliers was spent by the Non-

Regulated Affiliates.



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**EXECUTIVE SUMMARY STATEMENT: VI-2. IAWC could reduce its cost for accounting functions by up to \$1 million annually by outsourcing these services.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

The Audit Report has selectively chosen sub-functions from the Service Company's Finance unit and Shared Services unit relating to revenue processing, expense transactions, and internal reporting, and grouped these sub-functions as 'Accounting Services' as a potential candidate for outsourcing. Selectively choosing individual finance functions for outsourcing, however, will erode the benefits from economies of scale the Service Company's Finance organization is able to achieve by aggregating demand across multiple subsidiaries as reflected in its current cost structure.

Further, the Audit Report's analysis is inconclusive as it uses a small set of vendor data to obtain market pricing. The auditor contacted eight third-party services providers<sup>8</sup>, of which only two provided cost estimates for proposed accounting functions. Furthermore, one of the quotes states an estimated reduction of 10-20% from the current baseline rather than a cost build-up tied to the specified scope of work<sup>9</sup>. As such, IAWC believes using these two quotes does not provide a thorough market assessment.

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<sup>8</sup> Audit Report, p. VI-5.

<sup>9</sup> Audit Report, p. VI-7.

In addition, the Audit Report uses only a single vendor's \$960,000 to \$2,400,000 per year<sup>10</sup> quote to develop the savings estimate for the analysis. Such a wide range may indicate that if these functions were outsourced to a third-party provider, IAWC would be exposed to a wide cost variation that would have to be managed on an ongoing basis to keep actual costs of outsourced accounting functions within expected budgetary limits. Conversely, it is possible that the scoping definitions the Audit Report provided when collecting vendor cost estimates were not sufficiently detailed, in which case using a vendor quote may not be an accurate estimate of savings potential.

Finally, the Audit Report decides, without explanation, to use the lower-bound of the pricing quote in sizing the potential benefits of outsourcing, thus ignoring the variability in the vendor's response. In fact, the selection of the lower bound price estimate ignores the fact that the same vendor also quoted a high end estimate (\$2.4 million) that exceeded the cost of the Service Company's accounting services to IAWC (\$2.1 million). If the costs of the accounting services fall closer to the higher end of the vendor's quote, the Service Company's charges would be market competitive (i.e., \$2,046,599 of Service Company accounting charges<sup>11</sup> is less than the \$2,400,000 vendor quote). In fact, on an hourly basis, the Service Company charged IAWC a blended rate of only \$63/hr for accounting services in 2010,<sup>12</sup> which is low compared to industry billing rates that typically range from \$85/hour for new professionals to \$144/hour for managers according to "AICPA's<sup>13</sup> 2010 PCPS/TSCPA National Management of an Accounting Practice Survey." The Service Company's blended rate is also well below the \$126/hour average 2010 market rate for accounting services determined by the Service Company Cost Study

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<sup>10</sup> Audit Report, p. VI-7.

<sup>11</sup> Audit Report, p. VI-7.

<sup>12</sup> Audit Report, p. VI-4. (\$2,046,610 AWWSC accounting charges ÷ 32,316 AWWSC accounting labor hours charged = \$63/hr)

<sup>13</sup> American Institute of Certified Public Accountants, PCPS refers to the Private Companies Practice Section of the AICPA; TSCPA refers to the Texas Society of Certified Public Accountants.

undertaken by Deloitte & Touche LLP in Docket 09-0319. (Docket 09-0319, IAWC Ex. 11.01, Sch. 1.)

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**EXECUTIVE SUMMARY STATEMENT: IX-2. AWWSC costs for contact center services are higher than outsourced options, by \$428,831 or more per year.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

IAWC disagrees with this result because it does not reflect an accurate price comparison and it does not account for the value and importance of quality control with respect to customer contact services provided by the Service Company's Customer Service Center ("CSC").

Comparative Pricing Accuracy

Statement IX-2 is based on inaccurate and incomplete pricing comparisons. That is, the comparison between vendor hourly rates quotes and an estimated CSC hourly rate on which the result is premised does not account for at least six key differences between those rates. Moreover, the vendor rates do not reflect the entire scope of service and functionality provided by the CSC. As such, Result IX-2 overstates the potential savings attained by outsourcing components of the CSC.

First, the provision of customer service necessitates the interface between customer service personnel and field dispatch personnel in order for IAWC to adequately respond to customer needs, such as outage situations. The vendor hourly rate on which the Report relies assumes immediate access by outside vendors to the Service Company's Customer Information

System (“CIS”). However, that may not be the case. Rather, to develop an accurate comparison, the external vendor rate must take into account the added cost to interface with the CIS, as well as the dispatch functions of the FRCC and the Service Company’s web self-service. The Audit Report does not do this.

Second, Statement IX-2 is premised on preliminary pricing from outside vendors based on the CSC’s training materials for new call handling employees. However, the CSC provides education and training on an on-going basis, and it continuously develops training materials to adequately address American Water, regulatory and industry changes, updates, new processes and improvements. Such continued education and training are not incorporated into the external hourly rates on which Statement IX-2 is premised.

Third, the vendor rates on which Statement IX-2 is based do not include the costs of quality monitoring, calibration and reporting that assure call-handling effectiveness which meets IAWC’s high customer service standards. For this reason also, it is not accurate to compare that vendor pricing with the CSC hourly rate assumed by the Audit Report.

Fourth, the Audit Report’s estimate of potential benefits from outsourcing the CSC does not factor-in start-up costs associated with utilizing a third-party vendor. Specifically, that assessment does not consider the one-time costs of: (1) migrating to a third-party’s IT platform; (2) transitioning customer data; and (3) maintaining software licenses. Indeed, the Report acknowledges IAWC’s estimated “additional \$200,000 in start-up costs for training and cutover would be required if the contact center were to be outsourced.”<sup>14</sup> Incorporating that cost alone into the outsourcing benefits estimated by the Report reduces the initial potential savings projected to approximately only \$229,000, absent the other considerations discussed herein.

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<sup>14</sup> Audit Report, p. IX-9.

Fifth, Statement XI-2 does not account for the continued need to provide key functions currently provided to the CSC by the Service Company's business services support group, including overall coordination with state, local and field offices to assure seamless customer service delivery, issues management and regulatory support. For instance, the rate comparison on which Statement IX-2 is premised assumes access to the Service Company's IDA tool, but does not consider the on-going updates and administration of the IDA tool on which CSC Customer Service Representatives ("CSRs") rely for state-specific and premise-specific information provided by the Service Company's business services group.

Finally, the vendor hourly rates quotes on which Result IX-2 is premised do not encompass other cost considerations, including the costs associated with water-utility specialization, language translation capabilities, and water-specific training necessary for IAWC to meet customer inquiry needs. Additionally, it appears the vendor quotes account for only basic call data and existing basic training requirements. Thus, outsourcing CSC operations to vendors at the rates quoted likely would either reduce the quality of service to IAWC's customers or increase the cost of that service. For this reason also, an accurate comparison has not been made.

In sum, although the vendor hourly rate quotes on which Statement IX-2 is premised are lower than the estimated hourly rate of the CSC determined in the Audit Report, it is not accurate to compare those rates without also considering the additional costs addressed above, which are not encompassed within the vendor estimates set forth in the Audit Report.

#### Quality Control

Statement IX-2 also does not account for the importance and value to IAWC of maintaining control over the quality of its customer service, in light of public health and safety

concerns related to water utility operations. IAWC's customer service needs are currently well served by the CSC. Utilizing the CSC enables IAWC to maintain high standards of customer service because (1) the CSC exists to provide similar customer service to all American Water subsidiaries with similar customer service standards; (2) the CSC's CSRs are proficient in the needs not only of water utility customers generally, but of IAWC's customers specifically; (3) the interface between the various functions of the CSC provides efficiencies not otherwise realized; and (4) the CSC's dual facilities provide uninterrupted customer service to IAWC's customers. Maintenance of this high standard of service is essential in order for IAWC to provide the level of service its customers demand, to allow IAWC to ensure that it complies with regulatory requirements, and to permit prompt action in the event that notice of a boil order or service interruption is required. The Audit Report does not account for this in identifying a lower "outsourced" rate. In so doing, the Audit Report's conclusions ignore potential costs related to a decline in customer service, should the CSC be outsourced.

First, because the CSC provides customer contact support services to all American Water subsidiaries, it ensures that the high customer satisfaction standards demanded by Illinois customers, and accordingly by IAWC, are met. The CSC provides customer contact handling, collections, billing and related support to all American Water operating companies, including IAWC. As such, it shares with IAWC and the other American Water subsidiaries the vision and incentive for operational excellence and efficiency in providing customer service. In an effort to meet service level targets established by IAWC in conjunction with its operating company partners, the CSC focuses on performance, accountability and measurement. Management of consolidated customer service under the Service Company enables application of such standardized procedures, technologies and industry measurements for customer service across all

of American Water's service areas, and assures proper management control over various customer communications, regulatory compliance, and public health and safety concerns related to utility operations. Indeed, independent customer satisfaction and service quality results indicate that IAWC, in partnership with the Service Company's customer service operations, is achieving a high level of customer satisfaction and meeting increasing customer expectations. It is unclear that the Audit Report vendor quotes reflect pricing to meet customer satisfaction levels achieved by the CSC.

Next, the Audit Report does not consider the value of the industry knowledge and experience of the CSC call handling staff. The Service Company's CIS and IAWC's customer service needs are complex; the CSC's CSRs are knowledgeable and experienced in both. That proficiency, in turn, significantly impacts the quality of service provided. Outsourcing this work to less experienced call handling representatives may result in decreased service order accuracy, which can erode the downstream efficiency of IAWC's field operations and customer satisfaction.

Third, the Report acknowledges that "[f]ew providers [are] able to handle the entire customer service function."<sup>15</sup> Accordingly, Statement IX-2 instead concludes outsourcing several functions may provide cost savings. This ignores the efficiencies realized by the interaction between the current CSC functions, which may not be attainable if several of those functions are outsourced. For example, outsourcing the CSC would introduce new challenges for the interface between customer contact and field dispatch necessary to respond to outage situations and the like. As noted, the current CSC staff is highly proficient and experienced, resulting in continued accuracy and quality in handling customer inquiries as well as the creation of service orders for the field.

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<sup>15</sup> Audit Report, p. IX-7.



Finally, Statement IX-2 also overlooks the benefits resulting from the Service Company's maintenance of two CSC facilities—one in Pensacola, Florida and the other in Alton, Illinois. Because it operates as one customer service center in two locations, the CSC can adjust to local conditions without any impact on the availability of customer service. This results in seamless and uninterrupted customer service to IAWC's customers.

IAWC's position is that, given the considerations above, the contact services of the CSC cannot be outsourced. The Audit Report does not address this position, or explain how the vendor quotes take into account the need to maintain control over CSC functions to ensure high-level customer service and that regulatory requirements are met. Moreover, a failure by an outsource vendor to provide adequate customer service consistent with regulatory requirements could impose costs related to non-compliance. The Audit Report does not consider these costs in concluding that savings could be obtained by outsourcing the CSC contact function. As such, the Audit Report's result in this regard is incomplete and should be rejected.

**ILLINOIS-AMERICAN WATER COMPANY**  
**DOCKET 10-0366**  
**Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: X-4. It may be economically beneficial for IAWC to utilize a Professional Employer Organization (PEO) to provide multiple, bundled Human Resources (HR) services, with potential annual cost savings up to \$467,000.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

First, the Audit Report range of pricing is very broad, while the scope of services provided for that pricing is not clearly defined. The Audit Report states<sup>16</sup> that it obtained quotes from only two of eight PEOs contacted, with alleged savings ranging from \$300,000 to \$750,000 per year. The Audit Report does not define the scope of services that each vendor's pricing covers, nor does the Report clearly identify the reason for such a huge disparity in the quoted values to provide confidence that the services offered are comparable. Furthermore, the Audit Report picks only the lowest price estimate to determine the potential cost savings. Using only the cheapest estimate of \$300,000 to develop the saving estimate is overly simplistic, given concerns on service comparability, and sets unrealistic savings expectations for all stakeholders. Conversely, using the opposite end of the quote (i.e., \$750,000), reduces the potential savings benefit of outsourcing to only \$17,000.

Second, quality of service levels provided by third-party vendors are not guaranteed to meet current standards achievable by the Service Company's HR Services organization. About

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<sup>16</sup> Audit Report, p. X-10.

70% of IAWC's employees are covered by one of 13 bargaining unit agreements<sup>17</sup>. This raises potentially significant labor-relations complexities which third-party vendors must be able to manage on a day-to-day basis. Utilizing a quote from a PEO which is unable to manage multiple bargaining unit agreements would be an inappropriate comparison to the Service Company's HR organization. (And in fact, one of the reasons given by two of the PEO vendors for declining to bid was concern over the multiple union contracts). Additionally, utilizing a PEO would represent a significant shift in the HR operating model for IAWC, which may have further cost implications that have not been fully analyzed or estimated.

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<sup>17</sup> Audit Report, p. X-1.

**ILLINOIS-AMERICAN WATER COMPANY**  
**DOCKET 10-0366**  
**Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: X-9. HR administrative services (i.e., payroll processing, the BSC and other HR administrative functions) are available in the marketplace at a competitive cost, at a savings of up to \$275,589 annually for IAWC.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

Certain HR administrative functions within the Service Company may be viable candidates for outsourcing if the activity can be distinctly identified, a scope of work clearly specified, and quality of service delivery contractually enforced. The Service Company has been reviewing these opportunities, and in fact a number of HR functions have been outsourced, including payroll processing (making the Audit Report's recommendation to outsource payroll processing redundant). However, a careful analysis is required to determine the feasibility of outsourcing and impacts on other related functions. As indicated in the general response above, outsourcing isolated activities may inhibit the Service Company's ability to deliver economies of scale in its provision of service.

IAWC notes two inconsistencies in the Audit Report's methodology that may have resulted in overestimating the potential savings for HR administrative services:

- a) The Audit Report states "recruiting, outplacement, the employee assistance program, pre-employment screening services, and some payroll-related services

are outsourced.<sup>18</sup>” However, in identifying potential functions available for outsourcing, these same activities are included under “Other HR Administration”. It is unclear why the Audit Report would include additional savings<sup>19</sup> of about \$90,000 from outsourcing functions that are already outsourced.

- b) The Business Service Center is not a strategically appropriate candidate for outsourcing. Due to the complex and confidential nature of employee benefits, and the need to maintain an appropriate relationship between IAWC and employees, IAWC would utilize only affiliate personnel for the BSC. Therefore, it is not appropriate to include the BSC in any calculation of potential outsourcing benefits.

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<sup>18</sup> Audit Report, p. X-7.

<sup>19</sup> Audit Report, p. X-13.

**ILLINOIS-AMERICAN WATER COMPANY  
DOCKET 10-0366  
Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: XIII-1. AWWSC's charges to IAWC for executive assistant support exceeded the competitive market by \$401,756 in 2010.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

The Audit Report erroneously labels the amounts discussed in Chapter XIII-1 as Service Company charges to IAWC for "executive assistant support." These amounts in fact were charges to IAWC for benefit overhead and general overhead coming from Service Company overhead cost pools 0335<sup>20</sup> and 0330<sup>21</sup>. These cost pools, which are physical locations of Service Company offices providing services to the operating companies, include professional services from numerous functional areas, such as production, network, customer relations, technical services, finance, administration, supply chain, environmental management, legal, engineering, human resources, operational risk, external affairs, etc.

IAWC's percentage of charges based on customer count in its division/region in 2010 was about 25.03 percent. Accordingly, IAWC's share of the 0335 benefit overhead and general overhead was \$400,257 (that is, 25.03 percent of \$1,599,169). IAWC's share of 0330 benefit overhead and general overhead was \$19,785 (that is, 2.19 percent of \$902,745).

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<sup>20</sup> Service Company, Central Region OH Location

<sup>21</sup> Service Company, Western Region OH Location

The Audit Report's conclusion that charges for executive assistance support exceed the market is based on a misunderstanding of AW's system for accounting for and assigning overheads. It is not appropriate to examine overhead charges for a business unit within a location in isolation. An American Water location charges out its total overhead to affiliates receiving services from that location based on the relative proportion of professional labor charges to each affiliate served by that location. For some business units within a location, there may be little or no labor charged to an affiliate. However, due to limitations in AW's accounting systems, that business unit's overheads are charged out to affiliates in proportion to the location's total labor charges charged to those affiliates. Thus, an individual business unit may reflect a higher proportion of overhead than its labor hours would indicate. Other business units, however, which charge more hours to an affiliate, may reflect lower proportional overheads than labor hours would indicate. In total for the location in aggregate though, the proper proportion of overhead is charged to the affiliate.

The Service Company charges discussed in Chapter XIII-1 represent, therefore, not “executive assistant time,” but benefit overhead and general overhead (that is, office rent, utilities, equipment rental, etc.) costs arising from the operation of the physical location where professional services are provided to the operating units.

**ILLINOIS-AMERICAN WATER COMPANY  
DOCKET 10-0366  
Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: XIII-3. AWWSC's charges to IAWC for network services support exceeded IAWC's own rates for network services by \$101,204 in 2010.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

The Audit Report bases its conclusion on an incorrect assumption: "Work activities performed by the Service Company's network personnel are similar in nature to those conducted by dedicated IAWC network personnel."<sup>22</sup>

To the contrary, Service Company services are provided by employees who have different educational, professional and work experience backgrounds than the IAWC employees included in this sample. The Audit Report compares 446,678 hours worked by IAWC employees to 2,546 hours worked by Service Company employees. The IAWC employees include large numbers of clerical, hourly and lower-level employees. On the other hand, the Service Company work referred to by NorthStar was provided by two employees: a Sr. Project Manager, Network, tasked 100% to IAWC, who is a Licensed Professional Engineer, with many years experience in the design, construction, operation and analysis of water utility network operations; and an Operations Supervisor, who charged approximately one quarter of his time to IAWC, who has many years experience in the design, construction, operation and analysis of water utility network operations.

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<sup>22</sup> Audit Report, p. XIII-7.



**ILLINOIS-AMERICAN WATER COMPANY**  
**DOCKET 10-0366**  
**Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: XIII-4. AWWSC's charges to IAWC for executive management services were \$318,119 greater than the comparable cost of IAWC executive management in 2010.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

IAWC disagrees with this statement because (I) it does not account for the fact that the referenced executive services reflect extensive expertise provided by multiple executives, and such services cannot be replicated by simply hiring any one individual executive, and (ii) the finding is based on the improper assumption that the executive services provided to IAWC by the Service Company could be performed by IAWC's existing management without hiring one or more additional executives.

Ms. Karla Teasley, President of IAWC and Mr. Barry Suits, VP of Operations for IAWC do provide oversight and have overall responsibility for the day-to-day operations of IAWC. However, the Service Company is able to provide, on a shared basis, sophisticated management services expertise, which IAWC would otherwise be required to self-provide if it operated on a standalone basis. Moreover, this expertise is provided by multiple executive personnel and could not be replicated as a single executive.

The executive services IAWC receives include services from individuals who have broader responsibilities within AW and/or more extensive experience and expertise in various

areas which allows IAWC to receive advantages and economies of scale from being part of larger organization which can leverage management and operational expertise through the Service Co. Compensation for this level of executive services is commensurate with scope of responsibilities, experience and expertise, and may therefore be at higher levels than the executive leadership at IAWC. IAWC, however, benefits from these executive services while incurring only its allocated portion of the costs.

Given the wide range of expertise they provide, it would not be possible to replicate their services by hiring a single executive. Rather, if IAWC were to obtain these services on a standalone basis, IAWC would likely have to hire multiple additional executives to provide the range of services currently provided. The Audit Report's findings do not account for this. However, hiring even two additional executives, at the IAWC executive rate as calculated in the Audit Report (\$92.53/hour), would eliminate any of the purported \$318,119 savings reflecting in the Audit Report's finding. (2 executives @ 2080 hours = 4160 hours x \$92.53 = \$384,924)

Further, the Audit Report's finding appears to assume that the 1,184 hours of executive services would simply be absorbed by IAWC's current executive management, Ms. Teasley and Mr. Suits. However, the Audit Report does not explain how these two full-time utility executives would have the capacity to absorb an additional 1,184 hours of work to replace the services received from the Service Company. In fact, they do not have this capacity. Thus, the 1,184 hours of service, if provided by IAWC on a standalone basis, would have to be provided by at least one additional executive. However, IAWC would likely need to hire more than one executive to replace the services provided, and that would eliminate any "savings," and would instead be more costly than using Service Company personnel.

**ILLINOIS-AMERICAN WATER COMPANY  
DOCKET 10-0366  
Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

EXECUTIVE SUMMARY STATEMENTS:

**XVII-3. In 2010, the AWWSC Central Lab received less revenue from commercial customers than it should have based upon its commercial testing prices representing an additional IAWC credit of \$15,672.**

**XVII-4. The AWWSC Central Lab charged IAWC \$193,455 more than it should have, based upon the prices charged to commercial third-party and AWK non-regulated affiliates in 2010.**

**RESPONSE: IAWC disagrees with these statements for the reasons discussed below.**

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**Discussion:**

The Audit Report's assessment improperly assumes that pricing schedules applied to commercial third parties and non-regulated affiliates should also be applied to IAWC. This is incorrect, because the testing services provided by the Service Company's Central Lab to IAWC and its regulated affiliates are far more extensive and comprehensive than those provided to commercial third-parties and non-regulated affiliates. In short, the Audit Report's statement does not account for the difference in the scope of services between regulated operating companies and non-regulated or third party users.

The Central Laboratory is structured and staffed primarily to provide high quality, cost-effective drinking water and wastewater analytical services to the American Water regulated operating companies and is not operated as a commercial, for-profit entity within the American Water business lines. Under this structure the Central Laboratory does from time-to-time

identify smaller external analytical testing opportunities that increase the overall utilization of the fixed-cost base of the Laboratory. Revenues from these services are used as a direct offset to operating costs that otherwise would be passed on to the regulated companies. However, the scope of service requested by external entities is often different, and more limited, than the full scope of services the Central Laboratory provides to the regulated subsidiaries and the pricing reflects these differences. In addition, actual prices charged to external entities may vary from the price sheet amounts depending on the specific testing requirements. As the Audit Report recognizes, less than 10 percent of the Central Laboratory's testing is done for third parties or non-regulated affiliates.

In addition to analytical testing, the scope of service provided to the American Water regulated subsidiaries includes the following activities that, when conducted centrally by the Central Laboratory create overall process standardization and cost efficiencies for the regulated subsidiaries. The costs of these services are included in the charges to IAWC and regulated operating companies; these costs are not reflected in the charge to commercial users (who do not receive this level of service):

- 1) The Laboratory provides project management activities by designated documentation staff. These individuals work with local operations and water quality teams to create and manage the sample schedules, delivery of final reports, creating state forms, and electronic deliverable submissions to state regulators. They also manage the review of sample receiving (communicating anomalies such as temperature or preservation issues, broken containers), alerting state contacts on MCL exceedances and other laboratory alerts (quality control issues).

- 2) The Laboratory handles the initial preparation, logging and shipping of sample kits/coolers to the field including all sampling supplies (bottles, preservatives, ice packs, shipping containers, etc.) as well as the required regulatory documentation including pre-populated chain of custody forms and sampling instructions.
- 3) The turn-around time for the analytical work and related documentation is tailored to the specific requirements of the State agency and to meet operational or water quality needs. This can vary from same-day service to up to 14 days. Examples include taste and odor complaints, TOC removals, Pb/Cu customer concerns, security concerns, testing after tank painting needed to return the tank to service, and treatment process remediation or optimization.
- 4) 24/7 service is provided during emergency events to ensure rapid chemical/biological determinations as required by the situation and to support the response activities of our operations and water quality personnel.

The pricing for external clients does not include these activities and therefore would not be comparable to the full service offering required by our regulated subsidiaries.

Further, the Audit Report fails to reconcile its finding with the results of the Belleville Lab Study performed in IAWC's prior rate case, Docket 09-0319. The results of the Belleville Lab Study, which compared the Service Company's projected "per test" laboratory cost to the expected market "per test" cost for the test year, were not contested in the prior case.

The Belleville Lab Study utilized per test price data from three outside water quality testing labs for twenty-eight different water quality tests currently being performed by the Belleville Lab.<sup>23</sup> The per test prices of the outside vendors were adjusted for turnaround surcharges, the electronic data requirements of the tests, the need for limited receipt days for

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<sup>23</sup> Docket 09-0319, IAWC Ex. 5.00 (Rev.) (Grubb Dir.), p. 9.

microbial analyses, the need for multiple microbial slides and for sample disposal containers. The study concluded that, on a per-test basis, the American Water system would realize a total savings of \$2,305,374 in water quality testing costs in 2010 by performing necessary tests at the Service Company's Belleville Lab, rather than having an outside water quality testing lab perform the tests. Of this savings, IAWC would realize \$207,253 in 2010.

IAWC submits that the Docket 09-0319 Belleville Lab Study provides a more accurate comparison of services and costs from the Laboratory because it uses per-test pricing from commercial laboratories capable of a full service offering. By contrast, the Audit Report's use of the Lab's commercial test prices is not an appropriate comparison due to the limited nature of those services.

**ILLINOIS-AMERICAN WATER COMPANY**  
**DOCKET 10-0366**  
**Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: XXII-4. In 2010, IAWC paid between \$81,410 and \$271,410 more for Business Development (BD) services from AWWSC than if it had obtained those services from an independent BD provider.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

Due to the varying scope of BD services, estimating the annual costs requires case-by-case budgeting of labor hours related to specific tasks. Therefore, IAWC believes a more reasonable comparison is to compare BD costs on an hourly rate basis among service providers rather than a total annual cost basis. As explained below, based on an hourly rate comparison, IAWC is more competitive than the service providers surveyed by NorthStar.

The vendor quote used in the Audit Report's analysis covers a "bare-minimum" scope that includes only "general monitor and reporting" under a monthly retainer. This scope does not include the full suite of BD activities that AWWSC's BD group currently provides to IAWC. If IAWC requires higher-level services beyond "general monitor and reporting", it has to procure these services at additional cost. Based on the same vendor's pricing estimate, IAWC would have to incur hourly rates ranging from \$150 to \$200 /hour for these additional services. This represents a 30 to 70% increase over the \$115 hourly rate charged by AWWSC for total BD

services<sup>24</sup>. Therefore, IAWC disagrees with the Audit Report's assessment that IAWC paid between \$81,410 and \$271,410 more for BD services.

Finally, it is noted again that the Audit Report obtained only two vendor quotes, and picked the cheaper estimate (\$60,000 as opposed to \$250,000) to arrive at its projection of alleged cost savings. Use of the higher estimate would have eliminated most savings potential. The concerns with use of vendor pricing data are addressed in more detail in the General section above.

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<sup>24</sup> Audit Report, p. XXII-3. (AWWSC's BD group charges \$115.60/hour.)



**ILLINOIS-AMERICAN WATER COMPANY**  
**DOCKET 10-0366**  
**Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE STATEMENT SUMMARY: XXIII-1. IAWC could save about \$29,000 by outsourcing the government affairs function through participation in an industry association.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

The Audit Report has provided no assessment if the American Water Works Association (“AWWA”) would be able to provide the full range of government affairs services that the Service Company currently provides IAWC. Typically, the charter of industry associations is to provide representation on matters that are of common interest to all its members, without taking an aggressive advocacy position for any particular member company. Therefore, on issues that are specific to IAWC, it is unlikely that an industry organization, such as AWWA, will represent IAWC and its ratepayers at the same level of quality and commitment as a direct employee of American Water. For example, the great majority of AWWA members are municipalities and other government-owned entities whose interests are in significant part substantially different from those of IAWC and other investor-owned utilities who are regulated by state public utility commissions. Thus, IAWC participation in an industry association in lieu of its own representation through the Service Company’s government affairs unit would cause IAWC and its customers to forego current benefits and service levels.

**ILLINOIS-AMERICAN WATER COMPANY**  
**DOCKET 10-0366**  
**Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: VI-1. IAWC was charged \$34,293 in 2010 by AWWSC accounting business units that did not provide it with any services.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

Statement VI-1 is based, in part, on the Audit Report's conclusion IAWC was charged \$19,422 from the SSC-AWE accounting business unit for one hour of accounting services performed by an employee in this business unit for American Water Enterprises (AWE), a non-regulated subsidiary. (Audit Report, p. VI-5.) That conclusion represents a misunderstanding of the process by which benefit and general overhead at each Service Company location is allocated to IAWC and the other American Water subsidiaries. See IAWC's response to Statement XIII-1, discussed above, for an explanation of that process. In light of that explanation, it is clear the referenced charges were not due to one hour of services performed, but were due to the overhead distribution method of the Service Company billing system. Therefore, this is not an inappropriate charge from the Service Company. Rather, it is the result of an overhead distribution methodology designed to preserve computer data storage space. All overheads are distributed to IAWC appropriately using this methodology according to the terms of the Service Agreement. Finally, if the detail necessary to properly reflect overheads were to be applied, the

referenced amount would be zero, or close to zero, and overhead amounts for other business units providing services to IAWC at this location would be increased.

**ILLINOIS-AMERICAN WATER COMPANY**  
**DOCKET 10-0366**  
**Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: VII-1. AWWSC's inconsistent application of allocation methods for charges from the investor relations (IR) group resulted in IAWC being overcharged \$17,899 for IR services in 2010.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

Outside contract services for IR are not distributed as overheads, and therefore do not necessarily track labor costs. The costs for those contract services are divided equally between AW (Parent Co.) and the Service Company. The 50% charge to the Parent Co. is held there and is not further allocated to any of the subsidiaries. The remaining 50% portion is then charged through the Service Company to all the affiliates by assigning a Service Company cost formula, in this case formula 100003. As a result, IAWC received a higher proportion of contract services costs in the Services Company invoice (7.28%) than is typical for the overall allocation of IR costs (4.3%) because the 50% charged to the Parent Co. never flows through the Service Company invoice.

**ILLINOIS-AMERICAN WATER COMPANY**  
**DOCKET 10-0366**  
**Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: XIII-2. AWWSC inappropriately charged IAWC \$89,382 for overhead expenses incurred by Eastern Division Operations.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

This statement represents a misunderstanding in the Audit Report of the process by which benefit and general overhead at each Service Company location is allocated to IAWC and the other American Water subsidiaries. See IAWC's response to Statement XIII-1, discussed above, for an explanation of that process. In light of that explanation, it is clear the charges were not due to one hour of services performed by the Eastern Division Operations group as stated in the Audit Report<sup>25</sup>, but to the overhead distribution method of the Service Company billing system. As such, this is not an inappropriate charge from the Service Company. Rather, it is the result of an overhead distribution methodology that was designed to preserve computer data storage space. Other business units at the Corporate Service Company overhead location did perform services for IAWC. Therefore, overheads from this location are appropriately distributed to IAWC. Also, all overhead charges from this location are distributed to IAWC appropriately using this methodology according the terms of the Service Company Agreement. Finally, as previously explained, if the detail necessary to properly reflect overheads were to be applied in

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<sup>25</sup> Audit Report, p. XIII-6.

this instance, the referenced amount would be zero, or close to zero, and the overhead amounts for other business units at the same overhead location overhead amounts would be increased.

**ILLINOIS-AMERICAN WATER COMPANY**  
**DOCKET 10-0366**  
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DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: XVIII-1. In 2010, AWWSC charged IAWC \$2,220 for supply chain employee expenses and overhead when there was no labor charged and no benefits to IAWC from the charges.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

This result again represents a misunderstanding in the Audit Report of the process by which benefit and general overhead at each Service Company location is allocated to IAWC and the other American Water subsidiaries. Please see IAWC's response XIII-1, discussed above, for an explanation of that process. See also IAWC's responses to VI-1 and XIII-2, discussed above.

**ILLINOIS-AMERICAN WATER COMPANY  
DOCKET 10-0366  
Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: XXII-1. In 2010, IAWC was overcharged \$5,476 by AWWSC for software used by BD personnel.**

**RESPONSE: IAWC disagrees with this statement for the reasons discussed below.**

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**Discussion:**

Statement XXII-1 is based on IAWC's receipt in 2010 of 2,868 hours, or approximately 1.4 FTE, of support from Service Company Business Development personnel. The statement refers to Salesforce, a Customer Relationship Management tool implemented and utilized by Service Company Business Development personnel on behalf of IAWC and other American Water subsidiaries to track, manage, analyze and share information regarding historical, current and future business as well as business client support and sales initiatives. Salesforce allows those personnel to log all public and private water/sewer utility contacts and contact information of each water/sewer utility acquisition and competitive-based opportunity as well as specific individual water/sewer utility information such as financial, operational, contact dates, potential sales close dates and financial close dates. That information is utilized on behalf of IAWC to create business development growth plans in addition to facilitating the Company's annual business planning. The Salesforce software enables self-management of activity and real-time reporting and dashboard capabilities to management evaluation and tracking. In addition,



included within in the cost of each Salesforce software license are support and training services related to the software.

In order to adequately meet the needs of IAWC and the other operating companies in this regard, the Service Company maintains 50 Salesforce software licenses, at a cost of \$1,500 each, a portion of which is allocated to IAWC based on its customer count in accordance with the Service Agreement between IAWC and the Service Company approved by the Commission. That agreement provides that all costs for the provision of services in common between the Service Company and utility subsidiaries which are not directly assignable to one subsidiary are to be allocated on the basis of customer count. Based on that allocation methodology, IAWC's share of the Salesforce licenses amounts to the cost of 5 licenses, or \$7,576. The Salesforce software licenses are utilized by Service Company employees providing a number of services to IAWC and other subsidiaries. Therefore, there is not a one-to-one relationship between licenses and subsidiaries, nor would such cost allocation be appropriate, as the Audit Report suggests in concluding that IAWC should have been charged \$2,100 (1.4 FTE times \$1,500 per license cost), resulting in an alleged overcharge of \$5,476. For these reasons, IAWC disagrees with Statement XXII-1.

**ILLINOIS-AMERICAN WATER COMPANY  
DOCKET 10-0366  
Response to Final Audit Report**

DATE RECEIVED: January 11, 2012

COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: IV-1 AWK's most recent estimate of potential BT savings is \$29.6 million per year.**

**RESPONSE: IAWC disagrees with this response to the extent it lacks the qualifications provided by IAWC during the course of the audit regarding estimations of BT savings, as discussed below.**

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**Discussion:**

The Audit Report's Section IV otherwise sets forth the qualifications provided by IAWC during the course of the audit regarding the BT savings estimations it provided.<sup>26</sup> Those qualifications should be reiterated in the Executive Summary of the Audit Report to the extent that summary sets forth "results" on which "attention . . . should be focused."<sup>27</sup> Those qualifications are as follows: (1) The BT program is only approximately 40% complete, and AWK has approximately 50% confidence in its savings estimation at this time. (2) AWK and IAWC are still unable to confirm the amount of potential savings that may be realized as a result of BT and are unable to specifically identify how potential savings will be obtained.

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<sup>26</sup> Audit Report, p. IV-5.

<sup>27</sup> Audit Report, p. II-1.

**ILLINOIS-AMERICAN WATER COMPANY**  
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**Response to Final Audit Report**

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COMPANY: Illinois-American Water Company

RESPONSE DATE: February 10, 2012

**EXECUTIVE SUMMARY STATEMENT: IV-8. The \$5.5 million charged to IAWC for ITS cost are within industry norms. Combined BT and ITS costs of \$7.9 million exceed industry norms and the additional BT charges were not reflected in terms of reduced AWWSC fees and improved service quality in 2010.**

**RESPONSE: IAWC disagrees with this statement in part.**

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**Discussion:**

The \$7.9 million figure inappropriately combines existing IT costs and capital BT costs to compare to “norms” for ITS costs.